



## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 232

[Docket No. FR- 5537-P-01]  
RIN-2502-AJ04

### Federal Housing Administration (FHA) Section 232 Healthcare Mortgage Insurance Program: Partial Payment of Claims

**AGENCY:** Office of the Assistant Secretary for Housing – Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule.

**SUMMARY:** This proposed rule would amend the regulations governing FHA's Section 232 Healthcare Mortgage Insurance program (Section 232 program). The Section 232 program insures mortgage loans to facilitate the construction, substantial rehabilitation, purchase, and refinancing of nursing homes, intermediate care facilities, board and care homes, and assisted-living facilities. The amendments proposed by this rule would reduce risk to the FHA insurance fund by establishing the criteria and process by which FHA will accept and pay a partial payment of the claim under the FHA mortgage insurance contract. Through acceptance and payment of a partial payment of claim, FHA pays the lender a portion of the unpaid principal balance and recasts a portion of the mortgage under terms and conditions determined by FHA, as an alternative to the lender assigning the entire mortgage to HUD. Partial payment of claim would also allow FHA insured healthcare projects to continue operating and providing services.

**DATES:** Comment Due Date: **[Insert date 60 days from the date of publication in the Federal Register]**.

**ADDRESSES:** Interested persons are invited to submit comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

**1. Submission of Comments by Mail.** Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

**2. Electronic Submission of Comments.** Interested persons may submit comments electronically through the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov). HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the [www.regulations.gov](http://www.regulations.gov) website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

**Note:** To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

**No Facsimile Comments.** Facsimile (FAX) comments are not acceptable.

**Public Inspection of Public Comments.** All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between

8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an appointment to review the public comments must be scheduled in advance by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at [www.regulations.gov](http://www.regulations.gov).

**FOR FURTHER INFORMATION CONTACT:** Roger E. Miller, Deputy Assistant Secretary, Office of Healthcare Programs, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 6264, Washington, DC 20410-8000; telephone 202-708-0599 (this is not a toll-free number). Persons with hearing or speech disabilities may access this number through TTY by calling the toll-free Federal Relay Service at 1-800-877-8339.

#### **SUPPLEMENTARY INFORMATION:**

##### **I. Background**

FHA's Section 232 program insures mortgage loans to facilitate the construction, substantial rehabilitation, purchase, and refinancing of nursing homes, intermediate care facilities, board and care homes, and assisted-living facilities. A project may include more than one type of facility and financing, and a combination of these uses is acceptable. The Section 232 program is authorized under the National Housing Act (12 U.S.C. 1715w). HUD's regulations for the Section 232 program are codified in 24 CFR part 232. While many aspects of HUD's healthcare facility operations, including the basic contract and eligibility requirements, are governed by the regulations applicable to HUD's multifamily mortgage insurance programs, separate healthcare regulations have been adopted to address program operations specific to

healthcare facilities, such as state licensing requirements.<sup>1</sup>

One process well-established and long used in HUD's multifamily housing programs is acceptance of partial payment of claims (PPCs). Under the PPC process, FHA pays the mortgagee a portion of the unpaid principal balance and recasts a portion of the mortgage under terms and conditions determined by the FHA Commissioner (the Commissioner), as an alternative to assigning the entire mortgage. Prior to processing the PPC, the mortgagee must voluntarily agree to accept a partial payment of the insurance claim in accordance with the terms and conditions established by the Commissioner. The mortgagee must also waive any prepayment and lock out provisions in the mortgage.

Congress granted FHA authority to allow PPCs for subsidized insured multifamily properties in the Housing and Community Development Amendments of 1978 (12 U.S.C. 1701z-11). The legislative history reflects that a mortgagee's participation in a partial payment was voluntary and based on its own determination that such an arrangement would be in the mortgagee's own best interests.<sup>2</sup> In the Housing and Community Development Act of 1980 (12 U.S.C. 1701z-11), Congress expanded FHA's authority to allow partial payments of claims beyond subsidized projects to nonsubsidized multifamily rental housing project insured under the National Housing Act. In the Multifamily Housing Property Disposition Reform Act of 1994 (12 U.S.C. 1735f-19), a statute primarily directed to a broad overhaul of multifamily program operations, Congress clarified the voluntary nature of the PPC process and the program coverage. The regulations implementing the statutory authority to accept PPCs, which FHA

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<sup>1</sup> The regulations codified at 24 CFR part 200 (entitled "Introduction to FHA programs") set forth, in a single location of the Code of Federal Regulations, requirements that are generally applicable to FHA programs. The regulations at 24 CFR 232.2 require that facilities meet state licensing requirements.

<sup>2</sup> Legislative History (H. Rep. No. 95-1792 95<sup>th</sup> Congress, 2<sup>nd</sup> session) cited the preamble to the final rule establishing the regulations for PPCs. The cited preamble language is found at 50 FR 38784 (September 24, 1985).

adopted in 1985, and which are codified in § 207.258b, specifically excluded FHA's Section 232 program from the multifamily PPC process. (See 24 CFR 232.251(a).)

In 1997, Congress specifically authorized PPCs for the Section 232 program. (See 12 U.S.C. 1735 f-19.) However, the regulatory provisions governing the multifamily programs, which predated the 1997 statutory amendments, were not revised to reflect the statutory authority to use PPCs for healthcare facilities. Thus, the current regulations for the multifamily programs establishing the procedures and criteria for partial payments of claims for properties insured under other FHA programs are not applicable to the Section 232 program.

## **II. This Proposed Rule**

This proposed rule would provide, in regulation, the procedures and criteria for FHA to determine when PPCs should be considered and paid for healthcare facilities. To date, HUD has accepted PPCs in the Section 232 program on a periodic basis, but HUD has concluded that the criteria and procedures for granting PPCs in the Section 232 program should be established and codified in regulation.

In developing regulations governing PPCs in the Section 232 program, the current regulations governing PPCs, codified at 24 CFR 207.258b, for the multifamily programs serve as a helpful starting base. Additionally, this proposed rule is informed by FHA's experience implementing the PPC process in its multifamily housing programs, and FHA's experience in utilizing PPCs in the Section 232 program on a periodic and temporary basis.

This proposed rule adds a new § 232.882, entitled "Partial Payment of Claims," to the Section 232 program regulations in 24 CFR part 232. This new section provides that if the mortgagee elects to assign a mortgage to the Commissioner, under certain circumstances the

Commissioner may request the mortgagee to accept a partial payment of the claim. The proposed PPC regulations for the Section 232 program differ from the current regulations establishing the PPC process for the multifamily programs primarily because the focus of the Section 232 program is on healthcare facilities. While FHA must make a finding for multifamily programs that the project is, or potentially could serve as, a low- and moderate-income housing resource, the proposed PPC regulations for the Section 232 program provide for FHA to review, in its underwriting evaluation, the continued viability of the healthcare-specific aspects of the project. FHA must find that the project meets community healthcare needs, and will have sound management and project operation. Under the statute, FHA must make a determination that a PPC would be less costly to the government than other reasonable alternatives and would keep the healthcare facility operational to serve community needs.<sup>3</sup> The proposed rule specifies that requirement in § 232.882.

In addition, in an effort to ensure that the project will continue to be viable, and therefore beneficial to accept and pay the PPC, the proposed rule provides for certain determinations to be made. Specifically, FHA must find, as provided in proposed § 232.882(b)(4), that the current or proposed operator of the facility is satisfactory, as demonstrated by past experience in operating similar type healthcare facilities and by state regulatory performance evaluations. An example of the type of information that FHA may require is surveys/assessments by the state regulatory agency regarding the subject facility's performance. If there are outstanding deficiencies identified by the state regulatory authority or the Centers for Medicare and Medicaid Services,

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<sup>3</sup> See section 210 of the Department of Veterans Affairs and Housing and Urban Development Act of 1998. Public Law 105-65, approved October 27, 1997.

then FHA anticipates that an applicant would provide materials to FHA clearly establishing how those matters would be fully resolved.

In addition, FHA must determine that the default under the insured mortgage was beyond the control of the borrower and/or operator, or, in the case of a transfer of physical assets, the proposed borrower or operator, unless FHA determines that any borrower/operator deficiencies giving rise to the default have clearly been addressed. (See proposed § 232.882(b)(5).) For a new operator, for example, FHA would review information about the entity's experience and performance.

It should be noted that FHA's partial payment of claim is made pursuant to the contract of mortgage insurance between FHA and the mortgage lender, which are the only parties to the contract. Borrowers and operators are neither parties to the contract of insurance, nor are they third-party beneficiaries, and thus they do not have any rights or expectations in regard to any decision made by FHA to accept or reject a mortgagee's request for a partial payment of claim.

Further, FHA must specifically find that the project is serving or potentially could serve as a needed nursing home, intermediate care facility, board and care home, or assisted living facility. (See proposed § 232.882(b)(6).) Such a finding might be supported by a review of, for example, a market-need study or a project comprehensive needs assessment.

Other requirements specified in the proposed rule mirror the requirements for PPCs for multifamily projects. The proposed rule provides that FHA must find that:

- The mortgagee is entitled, after a default, to assign the mortgage in exchange for the payment of insurance benefits (see proposed § 232.882(b)(1));

- The relief resulting from partial payment, when considered with other resources available to the project, would be sufficient to restore the financial viability of the project (see proposed § 232.882(b)(2));
- The project is or can (at reasonable cost) be made structurally sound (see proposed § 232.882(b)(3));
- The default under the insured mortgage was beyond the control of the owner (see proposed § 232.882(b)(5));
- The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and other liens approved by the Commissioner (see proposed § 232.882(c)(1));
- The mortgagee has voluntarily agreed to accept a PPC under the mortgage insurance contract and to recast the remaining mortgage amount under terms and conditions prescribed by the Commissioner (see proposed § 232.882(c)(2)); and
- The owner has agreed to repay to the FHA Commissioner an amount equal to the partial payment, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the FHA Commissioner. The terms of the second mortgage will be case-specific to ensure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast insured mortgage (see proposed § 232.882(c)(3)).

By establishing a standard process and criteria for acceptance and payment of PPCs in the Section 232 program, partial payment of claims may occur more frequently than they do now in

the Section 232 program, not only resulting in savings to the FHA insurance fund, but helping to restore a project to financial stability.

### **III. Costs and Benefits of Rule**

In providing mortgage insurance for skilled nursing, intermediate care, assisted living, and board and care facilities, as compared to multifamily residential or other commercial properties, FHA's Section 232 program poses a significantly different risk to FHA because these facilities are designed specifically for healthcare use and may not retain the mortgaged value at resale due to a lack of alternative uses. Thus, when HUD becomes the mortgagee following a claim, the recovery rate—the sales price as a percentage of the unpaid balance—may be lower for healthcare facilities than for other types of properties.

HUD is proposing in this rule to establish standards for the use of PPC to minimize losses in the Section 232 program. Rather than paying the full claim to the lender, a PPC involves FHA and the lender restructuring the unpaid mortgage balance and accrued interest into two mortgages: one held by the lender and the second held by HUD. The lender's modified FHA-insured mortgage would range from 50 percent to 75 percent of the remaining unpaid principal balance. HUD's loan would include the remainder of the unpaid balance and the accrued interest.

The lenders, FHA, and the facility owners each benefit from the use of PPCs. The lender receives a portion of the unpaid balance, the full unpaid interest, and a performing loan. This is a method of curing the default with FHA rather than the borrower paying the lender. FHA avoids a full claim payment and sale of the mortgage and is entitled to be repaid the partial claim

payment with interest. The facility owners receive restructured debt and are able to continue operating the facility, which is also beneficial to the community that the facility serves.

The accompanying more detailed cost-benefit analysis is based on the Section 232 current portfolio, and based on the characteristics of the portfolio and the few cases where PPC was used in the program. FHA expects the typical mortgage accepted for PPC would range from \$5 million to \$20 million (original amount) and would occur 3 to 7 years after origination, following 10 to 30 months of delinquency. The savings to HUD equals the difference between the full claim amount and the partial claim paid, minus the discounted amount HUD receives from the HUD-held post-PPC mortgage.

Use of PPC also allows an assisted living, skilled nursing, board and care, or intermediate care facility to remain open to serve its residents and community. The extent of this benefit varies with the local market for long-term care. In smaller, less competitive markets, the facility may be the only option for its residents. In this case, if the facility were to close, residents and their families will have higher search and relocation costs, since local options would be limited, possibly requiring residents to have to relocate to another city or state. However, in larger, more competitive markets, residents may be able to find an alternative facility of similar cost and quality in the same community. In any event, residents will face relocation costs and possibly higher room rates or end up in a lower-quality facility.

The benefits of allowing PPC in the Section 232 program total \$891,000 per facility, which stem from avoided costs of moving by the facility's residents. Transfers totaling \$2.874 million occur from FHA and lenders that opt for PPC to FHA borrowers, as the avoided costs allow FHA premiums to not increase. FHA expects approximately five PPCs annually in the

section 232 program. Aggregating these effects produces annual benefits of \$4.455 million and annual transfers of \$14.369 million. For the full cost-benefit analysis, please see HUD's docket on [www.regulations.gov](http://www.regulations.gov) under the docket number of FR-5537-P-01.

#### **IV. Findings and Certifications**

##### **Information Collection Requirements**

The information collection requirements contained in this proposed rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a currently valid OMB control number.

The burden of the information collections in this proposed rule is estimated as follows:

##### **REPORTING AND RECORDKEEPING BURDEN:**

<b>Section Reference</b>	<b>Number of Respondents</b>	<b>Number of Responses Per Respondent</b>	<b>Estimated Average Time for Requirement (in Hours)</b>	<b>Estimated Annual Burden (in Hours)</b>
24 CFR 232.882	10	1	100	1,000
<b>Totals</b>	10	1	100	1,000

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

- (3) Enhance the quality, utility, and clarity of the information to be collected; and
- (4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this rule. Comments must refer to the proposal by name and docket number (FR-5537-P-01) and be sent to:

HUD Desk Officer  
Office of Management and Budget  
New Executive Office Building  
Washington, DC 20503  
Fax number: 202-395-6947  
and

Reports Liaison Officer  
Office of Housing  
Department of Housing and Urban Development  
451 Seventh Street, SW, Room 9116  
Washington, DC 20410-8000

Interested persons may submit comments regarding the information collection requirements electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

### Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

This rule is directed to strengthening HUD's Section 232 program by establishing a process and criteria by which the FHA may allow partial payment of claims for Section 232 projects. Establishment of this process also opens up another means by which healthcare project owners can restore troubled projects to financial stability. Acceptance of PPCs helps healthcare project owners and operators to lower project debt, and continue to provide valued healthcare services to the communities they serve. This established process for acceptance of PPCs will help all healthcare project owners, large and small. Accordingly, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities.

Notwithstanding HUD's determination that this rule will not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in this preamble.

### Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made, in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). That finding is available for

public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the finding by calling the Regulations Division at 202-402-3055 (this is not a toll-free number).

#### Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule will not have federalism implications and would not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

#### Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C.1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule does not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of UMRA.

#### Catalogue of Federal Domestic Assistance

The Catalogue of Federal Domestic Assistance Number for the Mortgage Insurance Nursing Homes, Intermediate Care Facilities, Board and Care Homes, and Assisted Living Facilities program is 14.129.

**List of Subjects in 24 CFR Part 232**

Fire prevention, Health facilities, Loan programs-health, Loan programs-housing and community development, Mortgage insurance, Nursing homes, Reporting and recordkeeping requirements

Accordingly, for the reasons cited in the preamble, HUD proposes to amend part 232 of title 24 of the Code of Federal Regulations as follows:

**PART 232 – MORTGAGE INSURANCE FOR NURSING HOMES, INTERMEDIATE CARE FACILITIES, BOARD AND CARE HOMES, AND ASSISTED LIVING FACILITIES**

1. The authority citation for 24 CFR part 232 is revised to read as follows:

**Authority:** 12 U.S.C. 1715b, 1715w, 1735f-19; 42 U.S.C. 3535(d).

2. Add § 232.882 to read as follows:

**§ 232.882 Partial payment of claims.**

(a) When a lender for a loan on a healthcare project becomes eligible to file an insurance claim and to assign the mortgage to the Commissioner pursuant to § 232.865, the Commissioner may request the lender, in lieu of assignment, to accept a partial payment of the claim under the mortgage insurance contract and to recast the mortgage, under such terms and conditions as the Commissioner may determine.

(b) The Commissioner may request the lender to participate in a partial payment of claim in lieu of assignment only after a determination that partial payment would be less costly to the Federal Government than other reasonable alternatives for maintaining the project and would keep the healthcare facility operational to serve community needs. In addition to any findings that may be provided in other guidance, the Commissioner shall base the determination on the findings listed below:

(1) The lender is entitled, after a default as defined in § 232.830, to assign the mortgage in exchange for the payment of insurance benefits;

(2) The relief resulting from partial payment when considered with other resources available to the project would be sufficient to restore the financial viability of the project;

(3) The project is or can (at reasonable cost) be made physically sound;

(4) The current or proposed operator of the facility is satisfactory to the Commissioner, as demonstrated by past experience in operating similar type healthcare facilities and by state regulatory performance;

(5) The default under the insured mortgage was beyond the control of the borrower and/or operator, or in the case of a transfer of physical assets (TPA), the proposed borrower or operator, unless the Commissioner determines that any borrower/operator deficiencies giving rise to the default have clearly been addressed; and

(6) The project is serving as, or potentially could serve as, a needed nursing home, intermediate care facility, or board and care home, or assisted living facility.

(c) Partial payment of a claim under this section shall be made only when:

(1) The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and such other liens as the Commissioner may have approved;

(2) The lender has voluntarily agreed to accept a PPC under the mortgage insurance contract and to recast the remaining mortgage amount under terms and conditions prescribed by the Commissioner; and

(3) The borrower has agreed to repay to the Commissioner an amount equal to the partial payment, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the Commissioner. The terms of the second mortgage will be determined on a case-by-case basis to ensure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast insured mortgage. The Commissioner may provide for postponed amortization of the second mortgage.

(d) Payment of insurance benefits under this section shall be in cash.

(e) A lender receiving a partial payment of claim, following the Commissioner's endorsement of the mortgage for full insurance under 24 CFR part 252, will pay HUD a fee in an amount set forth through Federal Register notice. HUD, in its discretion, may collect this fee or deduct the fee from any payment it makes in the claim process.

Date: June 28, 2012

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Carol J. Galante,  
Acting Assistant Secretary for Housing –  
Federal Housing Commissioner

**[FR-5537-P-01]**

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